

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Midwest Independent Transmission)
System Operator Inc.)**

Docket No. ER02-108-003

**COMMENTS OF THE
ILLINOIS COMMERCE COMMISSION**

Pursuant to Rule 211 of the Commission's Rules of Practice and Procedure, 18 C.F.R. §385.211, the Illinois Commerce Commission ("ICC") hereby submits its Comments on the filing submitted by the Midwest ISO in Docket ER02-108-003 on January 17, 2002. In support hereof, the ICC states as follows:

I. BACKGROUND

On January 17, 2002, the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO" or "MISO") tendered for filing with the Federal Energy Regulatory Commission ("FERC" or "Commission") its Contract for market monitoring services with Potomac Economics, Ltd.¹ The Midwest ISO's filing was submitted pursuant to the Commission's December 20, 2001, Order Granting RTO Status.²

After conducting a review of the Midwest ISO's Market Monitoring Plan, the Commission's December 20 Order directed the MISO to make public for review its Market

¹ The Contract is actually titled "Retention Agreement," but will be referred to herein as the "Market Monitoring Contract" or simply the "Contract."

² Midwest Independent Transmission System Operator, Inc., 97 FERC ¶61,326 (2001) (hereinafter "December 20 Order").

Monitoring Contract with Potomac Economics. The Commission explained its motivation for this directive as follows:

Without knowing the details of the contract we cannot be sure that the IMM [Independent Market Monitor] is truly independent of the RTO. For instance, since the IMM will be paid for its services pursuant to this contract, the Commission must be able to satisfy itself that the terms of payment cannot result in inappropriate incentives to find in favor of the RTO when reviewing the RTO's conduct, market rules, and procedures.³

The Commission further explained:

Assuming that we are satisfied following review of the actual contract with Potomac Economics, that the IMM will be truly independent, we find that the Plan will provide objective information about the markets that the RTO operates or administers and a vehicle to propose appropriate action regarding any improvements needed, market design flaws, or market power.⁴

The ICC Comments in this proceeding are not the first Comments the ICC has submitted to FERC regarding the MISO's market monitoring proposal. On November 19, 2001, the ICC submitted extensive Comments on the Market Monitoring Plan that MISO filed on October 15, 2001. In those comments, the ICC identified major concerns with the Plan in the areas of market monitor independence, state commission access to necessary market monitoring information, absence of market power mitigation measures in the Plan, and several more minor issues. The Commission, however, approved the MISO's Market Monitoring Plan in the December 20, 2001 Order (conditional on a satisfactory finding on review of the Contract) despite the various concerns previously set forth by the ICC. The ICC responded on January 18, 2002, with a Request for Rehearing of FERC's conditional approval of the Market Monitoring Plan.

The ICC has not altered its position on the Midwest ISO's Market Monitoring Plan. As the ICC has explained in its previous submissions to the Commission, the Market Monitoring

³ December 20 Order at 37.

⁴ December 20 Order at 37.

Plan still contains “many flaws” which the ICC will continue to urge the Commission to rectify. In the instant Comments, the ICC will limit its discussion to the Market Monitoring Contract that MISO made public for the first time on January 17, 2002.

II. ICC POSITION AND RECOMMENDATION

In its December 20 Order, the Commission only conditionally approved the Midwest ISO’s Market Monitoring Plan. The Commission reserved final decision until it is “satisfied following review of the actual contract with Potomac Economics, that the IMM will be truly independent . . .” It is the ICC’s position that the Commission should not be “satisfied” with the Midwest ISO’s Market Monitoring Contract in its present form. Careful review of the Market Monitoring Contract shows that its terms:

- (1) will allow MISO to control the Market Monitor through control of the budget, control of payments under the budget and control of contract termination;
- (2) will improperly require the Market Monitor to act as the agent of the Midwest ISO through “advising” and “reporting”;
- (3) are inconsistent with the terms of the Market Monitoring Plan; and
- (4) create conflicts of interest for the Market Monitor.

The ICC’s review of the Contract reinforces its previously stated view that the framework for market monitoring in the Midwest is not properly designed to ensure independence of the Market Monitor from the Midwest ISO. Independence of the Market Monitor from the Midwest ISO was a stated Commission condition to approving the Market Monitoring Plan. The Commission, therefore, should neither approve the Market Monitoring Contract nor extend final approval to the Midwest ISO’s Market Monitoring Plan. The ICC recommends that the Plan and the Contract be “remanded” back to the Midwest ISO with orders to engage its advisory process

and correct the flaws in the Plan consistent with the recommendations in the ICC's previous Comments as well as those identified herein.⁵

III. DISCUSSION

A. The Terms of the Contract Allow MISO to Control the Market Monitor Through Control of the Budget, Control of Payments Under the Budget, and Control of Contract Termination.

1. *MISO is Withholding Important Information About the Financial Terms of the Contract*

The Contract between the MISO and Potomac Economics establishes the overall budget for market monitoring (at 2). This dollar figure was redacted in the version of the Contract made available to the public. The ICC objects to this withholding of information by the MISO. No provisions were made in the December 20 Order for redacting any Contract information. Rather, the December 20 Order simply directed the MISO to "submit for review its contract with Potomac Economics." No conditions for redacting the Contract were stated. The public interest dictates that all parties be entitled to "review" the Contract in its entirety.

The MISO did not state reasons for redacting this Contract information nor did the MISO cite any authority for such redaction. The MISO's January 17 Cover Letter in this docket (at 1) merely states, "Due to the sensitive nature of the financial terms of the contract, the Midwest ISO respectfully requests the Commission to retain the Commission's copy under seal." The MISO

⁵ There is very recent precedent for this type of "remand" decision. For example in its January 30, 2002 Order Accepting in Part and Rejecting in Part Proposed Tariff Changes and Establishing Hearing Procedures, in the Midwest ISO's Docket ER02-485-000, the Commission took the same kind of action as with respect to a MISO incentive rate proposal as recommended by the ICC here. The Commission stated,

The Commission believes it is important to provide appropriate incentives to promote increased energy supply to customers. However, the Commission also believes that consultation and negotiation regarding such incentives are essential to successful implementation of incentive mechanisms. Therefore, we will direct Midwest ISO to submit its proposed Attachment N revisions to all stakeholders in the region to ensure that they provide appropriate incentives for efficient operation of and investment in the transmission system. 98 FERC ¶61,064, mimeo at 9.

states that it has made available a redacted version “for the general public’s use.” MISO Cover Letter at 1.

The redacted information regarding the financial terms of the Contract is precisely the type of information that will allow interested persons such as those who will ultimately pay for the costs of market monitoring in transmission rates as well as those who may suffer higher delivered power prices because of an inadequate market monitoring budget, to make an independent determination whether the market monitor will be independent of the MISO and whether the market monitor will have a sufficient budget (or an excessive budget) to perform meaningful market monitoring.

The ICC believes MISO’s request to keep confidential the Contract’s important market monitoring budget information is improper and not in the public interest. At a minimum, the MISO should be required to explain why it believes this information should be held confidential from market participants. There can be, however, no reason for holding this information confidential from public interest representatives, such as the ICC. Indeed, the ICC must have access to the market monitor budget information to be able to perform its public interest obligations. If the Commission determines it to be appropriate, the ICC is willing to enter into a confidentiality agreement with MISO and/or Potomac to view the market monitor budget information.

2. *The Contract Improperly Allows MISO to Establish the Overall Market Monitoring Budget*

The Contract provides MISO with the unilateral authority to establish the overall market monitoring budget allowance. To the ICC’s knowledge, no transmission customer (who will ultimately pay the costs for market monitoring) or other market participant (who may ultimately

suffer the financial consequences of seller market power if the market monitor's budget is set low enough to prevent the market monitor from doing an effective job) was involved in establishing this overall market monitoring budget. Neither were state commissions (to the best of the ICC's knowledge), whose responsibility is to protect the public interest, involved in this process. The ICC was certainly not invited to participate in setting the market monitoring budget or establishing the forms of payment.

This lack of input by interested entities and stakeholders is problematic for several reasons. MISO has every incentive to establish the overall market monitoring budget at levels that will prevent the Market Monitor from effectively monitoring the behavior and performance of the MISO itself. This market monitoring budget establishment process practically guarantees that the Market Monitor will not be independent of the Midwest ISO as the Commission required in the December 20 Order. Accordingly, the circumstances involving the establishment of the market monitoring budget and the MISO's ongoing control over that process will prevent the Commission from accurately determining that the "terms of payment cannot result in inappropriate incentives to find in favor of the RTO when reviewing the RTO's conduct, market rules, and procedures" as required in the December 20 Order.

3. *The Contract Improperly Provides for MISO to Control the Flow of Payments to the Market Monitor*

In addition to its overall budget-setting authority, which permits MISO to indirectly control the scope of activities of the Market Monitor, the Contract's payment provisions give MISO a mechanism to directly control the Market Monitor's scope of activity. The contract provision at issue provides as follows:

Potomac Economics is responsible for informing the Market Monitoring Committee when total billed amounts for services and expenditures reach 75% of

the total agreed annual budget. Upon such notification, the Market Monitoring Committee shall have the authority to modify your scope of work or activities under this Agreement to manage the costs incurred under this Agreement. Underlining added.⁶

The MISO may find it particularly useful to “modify” the Market Monitor’s “scope of work or activities” when the MISO itself is the subject of the Market Monitor’s investigations. This particular contract provision illustrates that the Market Monitor cannot be expected to act independently of the Midwest ISO and that the MISO can too easily control the activities of the Market Monitor. Granting of such an authority to the Midwest ISO on a budget management pretext is not in the public interest.

4. *The Contract Improperly Grants MISO Unilateral Authority to Terminate the Contract with the Market Monitor*

The Contract provides that the Midwest ISO may terminate the market monitoring contract with Potomac Economics with 30 days notice if the Midwest ISO is “dissatisfied with your work performance.”

This threat of sudden contract termination is likely to significantly impact the degree to which the Market Monitor will monitor the behavior and performance of the MISO itself. The Market Monitor will be unlikely to issue reports critical of the Midwest ISO for fear of creating “dissatisfaction” with its work performance.

It is inappropriate for the Midwest ISO to have this kind of contract termination power over the market monitor. The ICC, therefore, believes that this contract provision should be rejected in its entirety. If the Commission, however, elects not to reject it outright, the Commission should, as a minimum protection, require MISO to make a filing with FERC

⁶ Contract at 2.

explaining the reasons for the proposed Contract termination, and receive Commission approval before such termination can be implemented.

B. The Terms of the Contract Improperly Require the Market Monitor to Act as the Agent of the Midwest ISO Via “Advisory” and “Reporting” Functions.

1. *It Is Improper for the Market Monitor to Serve in an “Advisory” Role to the MISO*

The contract provides that the Market Monitor will directly “advise” the Midwest ISO.⁷ The ICC believes that this type of role is improper. The Market Monitor should not work, and should not be perceived to be working, on behalf of the Midwest ISO. Rather, market monitoring is a public interest function and the Market Monitor should, at all times, be perceived to issue “advice” in the public interest. In short, the Market Monitor should not act as an agent of the Midwest ISO nor should it be incented to act as an agent of the Midwest ISO. The Midwest ISO should be free to hire its own agents to perform that role.

2. *It is Improper for the Market Monitor to Serve in a “Reporting” Role to the MISO*

The Contract (Attachment A) requires the Market Monitor to “regularly report[] the findings of the monitoring function to the Market Monitoring Committee.” The Market Monitoring Committee will consist of representatives of the Midwest ISO.

The Market Monitor should not be “reporting” to the Midwest ISO. Rather, the Market Monitor should issue its reports in the public interest and submit them to the appropriate public interest agency.

⁷ Contract at 1.

3. *It is Improper for the MISO to Reserve a Special Option to Request Reports from the Market Monitor*

The Contract requires the Market Monitor to:

Perform[] investigations and analyses or produc[e] additional reports at the request of [the Midwest ISO's] management or Board of Directors.⁸

This contractual provision imposes an improper obligation on the Market Monitor by the Midwest ISO. The Market Monitoring Plan (Section 8.2) provides that any interested person may submit a request to the Market Monitor to perform an investigation. Section 8.2 of the Plan further provides that the Market Monitor shall have the discretion to conduct an investigation, or not, as it “deems appropriate.” The Midwest ISO should not be treated any differently with regard to requests for additional analyses from the Market Monitor.

Obligating the Market Monitor to perform investigations and issue reports at the request of the Midwest ISO is improper because it creates the appearance of impropriety. The Market Monitor's primary concern should be acting on behalf of the public interest as opposed to acting as an agent for the Midwest ISO.

C. The Terms of the Market Monitoring Contract are Inconsistent with the Terms of the Market Monitoring Plan.

1. *The Contract More Narrowly Defines the Scope of the Market Monitor's Duties than does the Market Monitoring Plan*

The Contract defines the scope of the Market Monitor's work much more narrowly than does the Market Monitoring Plan. The Plan establishes that the Market Monitor is responsible for monitoring, among other things:

the provision of transmission services and rights by the Cooperating RTOs, including but not limited to estimating and posting of Available Transfer Capability (“ATC”), administration of the tariff, the operation and maintenance

⁸ Contract, Attachment A at 2.

of the transmission system, the auctions and other markets for transmission rights, and the reservation and scheduling of transmission service. Underlining added.⁹

The Plan further provides that the Market Monitor will monitor:

competitive or other market impacts of tariffs and agreements, or other rules, standards or procedures, or any other RTO actions governing or affecting any of the Cooperating RTOs' Markets or Services. Underlining added.¹⁰

The Market Monitoring Plan clearly provides the Market Monitor with the authority and responsibility to review the Midwest ISO's conduct and even provides a minimum set of activities the Market Monitor is expected to carry out within that framework.

The Contract, however, does not reflect this same level of concern with potential negative market effects of the Midwest ISO's own conduct. Specifically, the Contract defines the scope of the Market Monitor's work as follows:

The IMM will monitor the markets and services facilitated by the RTOs for 1) flaws in market rules or procedures that create inefficiencies or gaming opportunities, and 2) strategic conduct by market participants that reduce the quantity or quality of the region's transmission service.¹¹

The "Scope of Work" provision found in Attachment A of the Contract does not encompass the entirety of the scope of work that was agreed to in the Market Monitoring Plan (and conditionally approved by FERC).

This raises the question of which document predominates—the Contract or the Market Monitoring Plan. Particularly troubling is a statement in the contract that states: "This letter [the Contract] constitutes the entire Agreement between Potomac Economics and [the Midwest ISO]." No reference to the Plan is mentioned in this regard. The ICC believes the Commission should ideally require revision of the Contract to eliminate any inconsistencies with the Plan. At a minimum, however, the Commission should clarify that the language of the Plan predominates

⁹ Plan, Section 5.1

¹⁰ Plan, Section 5.1

¹¹ Contract, Attachment A at 1.

over any inconsistencies with the Contract because the terms of the Plan were at least vetted with stakeholders prior to the Plan's filing with the Commission.

D. The Terms of the Contract Create Conflicts of Interest for the Market Monitor.

1. The Market Monitor Should Not be Required to or Allowed to Consult for the MISO

The Contract (Attachment A at 2) provides that the Market Monitor shall stand ready to perform an open-ended list of tasks directly for the Midwest ISO outside the budget cap provided for in the Market Monitoring Contract. The Contract specifically requires the Market Monitor to stand ready to perform tasks including:

Consulting with any of the RTOs on designing and implementing revisions to the market rules to resolve market design flaws.¹²

In essence, this means that the Contract requires the Market Monitor to stand ready to do consulting work for the Midwest ISO. A standing consulting arrangement between Potomac and the MISO raises serious questions as to whether or not Potomac will vigorously fulfill its public interest obligation as a market monitor, or modify its performance of the market monitoring role to increase profits in its consulting role.

Questions have recently been raised about whether or not the accounting industry rigorously performs "independent" auditing of company books (a public interest function) when doing so might jeopardize the continued receipt of profitable private consulting contracts. The same questions are raised here about the conflict between public interest functions (market monitoring) and private interest functions (consulting). Leaving such questions unresolved would seriously undermine the necessary level of trust in the Market Monitor.

¹² Contract, Attachment A at 2.

Finally, the Contract provides that the Midwest ISO shall receive these consulting services from the Market Monitor “at the same hourly rates” as were negotiated by Potomac for the provision of market monitoring services.¹³ This provision is improper. The Midwest ISO should not be permitted to negotiate a bargain on consulting by tying that arrangement to obtaining market monitoring services. The Midwest ISO should be required to negotiate for consulting services in the consulting services market separate and apart from the deal negotiated to obtain market monitoring services.

2. *The Market Monitor Should Not be Required to or Permitted to Testify for the MISO*

The contract (Attachment A at 2) provides that Potomac Economics shall:

provide supporting analysis and testimony in support of FERC filings by the Party [Midwest ISO] to address patterns of conduct or market design flaws identified through the market monitoring process. (Emphasis added).

This is not a proper duty for the Market Monitor. Instead, the proper role of the Market Monitor is to identify market problems and propose solutions on behalf of the public interest. The Market Monitor should not exist to serve the litigation needs of the Midwest ISO.

Once the Market Monitor has issued its report, and the Midwest ISO has made public its proposal to address any market problem identified by the Market Monitor, the Market Monitor should be free to comment, or not comment, on the Midwest ISO’s proposed solution in the same manner as any other interested party. The obligation that the Contract places on the Market Monitor to testify in favor of the RTO’s proposed solution prevents the Market Monitor from independently reviewing and responding to the RTO’s proposal.

In short, the Market Monitor should not work, and should not be perceived to be working, on behalf of the Midwest ISO. Rather, Market Monitoring is a public interest function and the

¹³ Contract, Attachment A at 2.

Market Monitor should, at all times, abstain from engaging in activity that could compromise performance of this public interest responsibility.

3. *The Contract Does Not Prevent Employees of Potomac Economics from Engaging in Potentially Conflicting Business with the Midwest ISO and with Market Participants*

While the contract includes a conflicts of interest policy (Attachment B), it does not prevent conflicts of interest. Attachment B of the Contract states that,

The IMM and other members or employees of his or her firm may not undertake a matter for or on behalf of an Interested Party involving the structure or performance, or the rules, standards and procedures, of a market for electric energy or ancillary services of one of the RTOs. For purposes of these rules, the term "Interested Party" shall mean: (a) a Market Participant; or (b) a person or entity with a significant financial or policy interest in the organization, governance or operations of the RTOs, but shall not include the RTOs themselves or predecessor organizations.

Because the term “Interested Party” is specifically defined to exclude the Midwest ISO, this conflict of interest policy does not prohibit Potomac Economics from entering into lines of business with the Midwest ISO that would potentially jeopardize its purported independence from the Midwest ISO.

In addition, this conflict of interest policy prohibits Potomac Economics from entering into only a very limited range of business transactions with market participants in the Midwest. Specifically, Potomac Economics is only prohibited from entering into a business relationship with market participants involving “the structure or performance, or the rules, standards and procedures, of a market for electric energy or ancillary services of one of the RTOs.” The whole universe of other entanglements with Midwest market participants is open to Potomac Economics provided that the Midwest ISO, “in its sole discretion,” determines that the “independence or integrity” of the Market Monitor would not be compromised.

Such conflict of interest loopholes must be closed because they compromise trust that the Market Monitor is critically and fairly assessing the behavior of both the Midwest ISO and the market participants in the Midwest. There can be no confidence in the Market Monitor if there remain nagging questions about whether the Market Monitor is pursuing agendas other than conducting market monitoring in the best interest of the public.

IV. CONCLUSION

Wherefore, for all of the reasons explained above, the Commission should: (1) not approve the Midwest ISO's Market Monitoring Contract; (2) not grant final approval of the Midwest ISO's Market Monitoring Plan; (3) *remand* the Market Monitoring Plan and Market Monitoring Contract back to the Midwest ISO and direct the Midwest ISO to engage its advisory process and correct the flaws in both the Market Monitoring Plan and in the Market Monitoring Contract.

Dated: February 7, 2002

Respectfully submitted,

/s/ Thomas G. Aridas

ILLINOIS COMMERCE COMMISSION

Myra Karegianes
General Counsel and
Special Assistant Attorney General

Thomas G. Aridas
Special Assistant Attorney General
Illinois Commerce Commission
160 N. LaSalle, Suite C-800
Chicago, Illinois 60601
(312) 793-2877